IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-1305

PUBLIC SERVICE COMMISSION OF
THE STATE OF NEW YORK,

Petitioner,

v.

FEDERAL POWER COMMISSION,

Respondent.

**PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT
OF APPEALS FOR THE
FIFTH CIRCUIT**

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Petitioner, the Public Service Commission of the State of New York (New York), respectfully prays that a writ of certiorari be issued to review the opinion and judgment of the United States Court of Appeals for the Fifth Circuit entered in this case on October 1, 1975.

OPINION BELOW

The basic opinion of the Court of Appeals of October 14, 1975, from which review is sought is reported at 520 F.2d 1061. A *per curiam* order on rehearing issued Janaury 14, 1976 is reported at 525 F.2d 1261. These opinions and orders are set forth as Appendix A and B respectively of the separate appendix to Petition for a Writ of Certiorari being filed in this Court under the style of *The California Company, a Division of Chevron Oil Company v. Federal Power Commission.*[1]

JURISDICTION

The opinion and judgment of the Court below was entered on October 14, 1975. On January 5, 1976, Mr. Justice Powell entered an order extending the time within which New York could file a petition for writ of certiorari until March 12, 1976. This Court's jurisdiction is invoked under 28 U.S.C. § 1254 (1) and Section 19 (b) of the Natural Gas Act, 15 U.S.C. § 717r(b).

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[1] For the convenience of the Court the several parties filing petitions from the opinion and orders of the court below agreed that a single appendix incorporating the relevant orders of the Commission and the Circuit Court, and governing provisions of the Natural Gas Act would be filed by the California Company with its petition, but could be referred to as (Pet. App. ____). References to other portions of the record before the Commission printed in the Joint Appendix submitted to the Court below are cited as (J. A. ____).

QUESTION PRESENTED

Whether the Federal Power Commission in a rule-making proceeding limited to fixing a nationwide rate for new gas could properly make this rate automatically applicable to the oldest and lowest cost flowing gas, at a multibillion dollar cost to consumers, whenever the initial sales contract expires and the producer and pipeline enter into a replacement contract, regardless of whether the producer agrees to devote any of the resulting additional revenues to the development of additional gas for the interstate market?

STATUTORY PROVISIONS INVOLVED

The relevant portions of the Natural Gas Act 15 U.S.C. § 717 *et seq.*, are set out as Appendix E to the Appendix to the California Company Petition for Certiorari (See note 1, *supra*).

STATEMENT OF THE CASE

This case arises out of the decisions of the Federal Power Commission in Opinion Nos. 699 and 699-H (Pet. App. C and D) fixing a nationwide rate, at a base price of 50 cents per mcf, for new gas sold by producers in interstate commerce for resale. The instant petition is limited to those portions of the Commission's opinion and orders which made the higher new gas price adopted therein automatically applicable to continued deliveries of flowing gas upon the expiration

of the initial sales contracts therefor and the filing of new contracts covering the same service.

The Public Service Commission of the State of New York is a regulatory body established under the laws of the State of New York having jurisdiction *inter alia* over the operations of distributors of natural gas at retail in the state. Almost all of the gas sold in the state is acquired by those distributors from interstate pipelines subject to the jurisdiction of the Federal Power Commission (Commission), who in turn secure most of their gas directly or indirectly from independent producers pursuant to sales regulated by the Commission. Consequently, New York, in order to protect the interests of gas consumers in its state, has for a number of years found it necessary to participate actively in Commission proceedings involving both the pipelines serving the state and looking towards the fixing of just and reasonable area or national rates for producer sales to the pipelines. In accordance with this established policy, New York participated actively in the Commission proceedings leading towards the opinions in issue here, and brought a review action in the court below challenging the legality of the same facet of the Commission's opinions to which the present petition is directed.

Since we are directing our petition to a single important issue we limit the statement below to those considerations necessary to an understanding of this facet of the Commission's action.

A. The Administrative Background

Since the initiation of group rate making in the *Permian Basin Area Rate Proceeding*, 34 F.P.C. 159 (1965), affirmed *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), the Commission has consistently fixed two sets of just and reasonable rate ceilings, one for flowing gas and another higher level for new gas. The flowing gas rate was and is established essentially to reflect the average historical costs of existing production, but the new gas rates have been fixed on a current cost basis intended to encourage an enhanced gas search effort by the producers. As the Commission found in its *Permian* opinion, 34 F.P.C. at 186, "the two-price system . . . provides a price for the future related to current and future costs and payable only to producers who discover gas-well gas and dedicate their discoveries to the interstate market" while "avoiding windfalls to those producers who acquired and sold gas under lower cost conditions." See also *Permian, supra*, 390 U.S. at 798.

The dividing line between new and old gas was normally fixed in the area proceedings at some date around the commencement of the proceeding, and, as a matter of convenience, *Permian* and the subsequent area rate proceedings applied these dates to individual sales on the basis of whether or not the sales contract had been made before or after the date chosen. See 34 F.P.C. at 189. The Commission recognized in its original *Permian* opinion, however, that overly rigid adherence to contract date vintaging could be detrimental to the public interest. Accordingly it instituted therein (34 F.P.C. at 1068-1072) a separate proceeding

leading to Opinion No. 567, *Hugoton-Anadarko Area Rate Proceeding (Committed Acreage)*, 42 F.P.C. 727 (1962) in which it specified that all gas produced from deeper drilling in previously committed acreage would secure the new gas price, regardless of the date of the underlying contracts governing such sales.

This concept was further expanded in 1972 when the Commission in establishing its *Optional Procedure for Certificating New Producer Sales of Natural Gas*, 48 *F.P.C.* 218 (1972), *affirmed* in major part in *Moss v. FPC* 502 F.2d 461 (D.C. Cir., 1974) and as to the remainder by this Court in *FPC v. Moss*, Case No. 74-883, decided March 3, 1976, made its procedure for seeking rates in excess of the established ceilings for new sales of gas applicable to all *wells* drilled after April 6, 1972, regardless of whether the acreage was already dedicated to interstate commerce. In taking this action to "encourage full development of such acreage", the Commission stated its belief that its policy of distinguishing between new and old gas on the basis of contract date "had failed to achieve full development of dedicated acreage" (48 F.P.C. at 227), but it also emphasized that the optional procedure was "directed at supplies of gas not available to the interstate market prior to April 6, 1972. The rulemaking does not authorize rate increases for gas already flowing in interstate commerce through wells drilled prior to April 6, 1972 . . . [thus] consumers will not pay higher rates except for new supplies and then only to the extent that the contracting parties establish on record that the price to be paid is required by the public interest" (48 F.P.C. at 220).

While the Commission continued to maintain the

distinction between old and new gas, it recognized that situations would exist where increases in flowing gas rates could make additional gas available to the interstate market. Procedures for seeking such increases had been written into all of the area rate orders. See *Permian Basin Area Rate Cases, supra,* 390 U.S. at 770,771. And upon proper showings the Commission has in fact granted substantial relief to producers. (See, *e.g. Shell Oil Company,* 49 F.P.C. 108 (1973); *George Mitchell and Associates* 49 F.P.C. 424 (1973). Moreover, on November 8, 1972 the Commission moved to institutionalize this procedure by the issuance in Docket No. R-458 of a proposed policy statement, subsequently finalized on April 23, 1973, to encourage producers to seek rate increases in excess of area flowing gas rates where reduced well pressure, need for reconditioning of wells, deeper drilling or other circumstances made additional production of existing wells uneconomic at existing flowing gas ceilings.[2] In short, as of the time of the initiation of the present proceeding, Commission procedures already existed whereby producers with flowing gas could secure higher rates, before or after the expiration of the initial sales contract, if and to the extent that they could show a need therefor to maintain or increase production. Such procedures were supported by New York and other consumer representatives, as proper exercises of the Commission's authority to "employ price functionally in order to achieve relevant regulatory purposes."

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[2] *Policy With Respect to Sales Where Reduced Pressure, Need For Reconditioning, Deeper Drilling or Other Factors Make Further Production Uneconomical at Existing Prices,* 49 F.P.C. 992 (1973), codified as 18 C.F.R. § 2.76.

(*Permian Basin Area Rate Cases, supra,* 390 U.S. at 797.)

On December 12, 1972, however, the Commission suddenly took a different tack. In Opinion 639, the Commission rejected a proposed higher new gas rate for the Appalachian Basin production area (supported by New York) in favor of individual producer utilization of the newly adopted "optional procedure" (See *supra,* p. 6), again stressing that this procedure would permit higher prices for new gas sales where they were instituted without increasing the rates for flowing gas. *Area Rates for the Appalachian and Illinois Basis Areas,* 48 F.P.C. 1299, 1307. However by way of dictum the Commission stated that in view of its objections to "vintaging by contract date" it considered "vintaging to be an anachronism which we should now work to eliminate" (48 F.P.C. at 1309).[3] Accordingly it indicated that it would henceforth adopt a literal interpretation of its various area rate orders under

[3] The Commission attempted to bulwark its statement of policy by suggesting that the Commission had originally contemplated gradual elimination of the two price system, citing for this proposition the Commission's 1960 statement, prior to the initiation of any area rate proceedings, that it expected that the differentials between its "guideline" prices for initial certification of new gas sales and for accepting increased rate filings without suspension would disappear over a period of time. See Statement of General Policy No. 61-1, 24 F.P.C. 818 (1960). In fact, the difference between the initial and increased rate guidelines in most but not all production areas, adopted on an *ex parte* basis by the Commission, were unrelated to the date of original production or contractual commitment to the interstate market, or to the subsequent development of and rationale for the two-price area rate policy.

which sales of flowing gas would be eligible for the higher new gas rates where initial sales contracts had expired and the parties entered into new sales contracts.

The lawfulness *vel non* of this policy was subsequently affirmed in *Shell Oil Company v. F.P.C.* 491 F.2d 82 (5th Cir., 1974), as a permissible exercise of its discretion to interpret its own orders.[4] the Court recognized the potential validity of the claims by New York and others that the gas supply objectives underlying the Commission's policy might be impaired rather than aided and made clear that its action was not to be taken as a blanket approval of all future actions by the Commission to eliminate vintaging: "in each future rate order the Commission must continue to produce substantial evidence to support each essential element of the proposed rate structure" (491 F.2d at 89-90).

B. The Instant Proceeding

The present case was initiated by a notice of proposed rule-making in Docket No. R-389-B issued by the Commission on April 11, 1973 (J.A. I, 1). The proceeding was entitled, "Just and Reasonable National Rates for Future Sales of Natural Gas from Certain

[4] Challenges to specific implementations of this policy statement were recently rejected by a 2-1 vote of the court in *Public Service Commission of the State of New York, et al. v. F.P.C.*, ____ F.2d ____ (Case Nos. 73-1647 *et al.*, D.C. Cir., issued January 27, 1976). It is contemplated that petitions for certiorari from this opinion will be filed.

Wells," and the notice indicated that "the single uniform just and reasonable rate to be determined by final order herein shall apply to all jurisdictional sales of natural gas produced *from wells commenced on or after January 1, 1973*, except sales certificated under Order No. 431 [short-term sales], or Order No. 455 [the optional procedure]" (J.A. I, 1, emphasis added). The Commission made clear in the notice that it intended to institute a separate rulemaking proceeding "for the establishment of a single national just and reasonable rate for gas sold in interstate commerce from wells commenced prior to January 1, 1973" (J.A. I, 6-7). Such a proceeding was, in fact, initiated on May 23, 1973 by Notice of Proposed Rulemaking in Docket No. R-478, *Nationwide Rulemaking to Establish Just and Reasonable Rates for Natural Gas Produced from Wells Commenced Before January 1, 1973*, 38 F. R. 14295.

Comments and reply comments were filed by numerous parties, including New York on May 16, 1973 and June 1, 1973 respectively (See J.A. III, 218, 220, 288, 289). On March 21, 1974, the Commission issued a supplemental notice calling the attention of the parties to a revised staff nationwide new gas cost study and a staff study of certain AGA data. The parties were invited to file new comments on those studies, as well as on five discrete questions propounded by the Commission (J.A. I, 130-132). Again, nothing in the notice suggested the Commission contemplated expanding the proceeding to encompass any flowing gas. New comments in response to the Commission's supplemental notice were then filed by a number of parties. In the supplementary comments filed by a group of the

major producers (J.A. III, p. 310), it was suggested that the Commission, consistent with Opinion 639, should make its nationwide new gas rate applicable to flowing gas sales when the initial sales contract expires and a new one is entered into. This suggestion was opposed by New York in its supplementary reply comments filed on May 29, 1974 (J.A. IV, pp. 644-648).

On June 21, 1971, the Commission issued its Opinion 699 in this proceeding (Pet. App. C). For purposes of this petition it is sufficient to note that Opinion 699 established a nationwide base rate for new gas of 42 cents per mcf, as of January 1, 1973, with one cent escalations annually. This rate was made applicable to interstate sales undertaken:

(1) from wells commenced on or after January 1, 1973;

(2) pursuant to contracts on or after January 1, 1973, for the sale of gas not previously sold in interstate commerce except on a short term basis under certain Commission regulations; and

(3) "pursuant to contracts executed on or after January 1, 1973 where the sales were formerly made pursuant to permanent certificates of unlimited duration under contracts which expire by their own terms on or after January 1, 1973" (Pet. App. C-2 to C-3).

The Commission gave as its reason for changing its proposal to include flowing gas sales that its action was "consistent" with that taken in Opinion 639, would make additional revenues "available" to producers for expanded exploration and development efforts, and would "offset the claimed attrition in rate of return in various discounted cash flow studies presented by

producer respondents" (Pet. App. C-107 to C-108). No mention was made of the pending proceeding in Docket R-478, and nothing was stated in response to New York's contrary arguments. Commissioner Smith dissented from this aspect of the Commission's action, finding it to be unsupported by the likelihood of benefit to gas consumers. (Pet. App. C-230 to C-232).

Numerous petitions for rehearing of Opinion No. 699 were filed. New York's petition (J.A. IV, 729) among others, expressly challenged the Commission's action in making the new rate applicable to flowing gas sales. At the oral argument held on August 22 and 23, 1974, counsel for New York again set forth the reasons why New York believed the new rate should not apply to flowing gas (See J.A. III, p. 55-56), as did counsel for the Associated Gas Distributors (AGD) (See J.A. III, 38-43).

On December 4, 1974, the Commission issued its Opinion No. 699-H (Pet. App. D). In this opinion, the Commission increased the nationwide base rate to 50 cents per mcf. Opinion 699-H totally ignores the arguments made in the petitions for rehearing and on oral argument by New York and other parties opposing the automatic applicability of the new gas rate to flowing gas sold under replacement contracts. It does discuss, however, a number of requests by the *producers* to enlarge the coverage of its order to include even greater amounts of flowing gas within the new gas umbrella (Pet. App. D-43-D-47). While it rejected a request to make the new gas rate available to flowing gas whenever the initial sales contract expires in situations where the producer and pipeline had failed to enter into a new contract (Pet. App D-45-D-46), it

modified the availability clause to include flowing gas sales where the term of the initial sales contract expired after January 1, 1973, but the replacement contract had been entered into *prior* thereto (Pet. App. D-44).[5]

Commissioner Smith again dissented from the Commission's action making the new gas rate available to flowing gas (Pet. App. D-112 to D-116). He calculated that the cost to consumers could reach as high as $2.6 billion through 1981, without considering any increases in the new gas rate which might stem from the biennial review provided for in Opinion No. 699-H (*id. at* D-114.) He concluded that the Commission's action was inconsistent with its notices in the proceeding, and that even assuming there were a need to provide additional internal financing for producers, making the new rate available to such flowing gas as would become eligible under the Commission's order was a discriminatory and ineffective method of achieving this objective (*ibid*).

On appeal the Court of Appeals for the Fifth Circuit affirmed the Commission in all respects (Pet. App. A). The court agreed that there was much to be said for the arguments of New York, AGD and the American Public Gas Association that automatically giving the new gas rate to flowing gas sold under replacement contracts would inhibit rather than encourage future development. It concluded, however, that the Commission's determination was lawful since it rested on substantial evidence as to the existence of a gas supply

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[5] The final form of the provision for making the nationwide new gas rate applicable to flowing gas sales is set out as Section 2.56(a)(3)(iii) of the Commission's Statements of General Policy and Interpretations, 18 C.F.R. 2.56(a)(3)(iii) (Pet. App. D).

deficiency and the need of producers for a "massive infusion of funds" to conduct an optimum gas search effort, and since a review of the efficacy of the particular non-cost bonus adopted by the Commission would be undertaken in the biennial review proceeding the Commission had initiated. (Pet. App. C-112 to C-114).

REASONS FOR GRANTING THE WRIT

The Commission in this case adopted a 50 cent nationwide base rate for new gas, approximately double the previous rate ceilings for such gas. New York does not challenge this determination which we believe was within the Commission's discretion as elucidated by this Court in the *Permian Basin Area Rate Cases*, 390 U.S. 747 (1965) and *Mobil Oil Corporation v. FPC*, 417 U.S. 283 (1974). We do challenge the lawfulness, however, of a multibillion dollar[6] non-cost supplement to this

[6] The exact cost of the allowance depends on several variables not presently known. Commissioner Smith in his dissent estimated the cost through 1981 at 2.6 billion dollars, based upon then current flowing gas rates and assuming no increase in the nationwide new gas rate during this period. If one uses the 24.5 cent flowing gas rate, subsequently fixed in Docket R-478 by the Commission's order of December 31, 1975, (and assumes that the 6 cent increase in this rate as of July 1, 1976 for increased federal income taxes will also be applied to the new gas rates), the cost through 1981 would be in excess of 1.8 billion dollars. And if the replacement contracts continue to secure the new gas rate as it is increased in the biennial review proceedings contemplated by the Commission the cost will be greatly in excess of this figure; thus in the first of these proceedings in

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rate which resulted from the Commission's decision to classify as "new gas" the oldest and least costly flowing gas whenever the initial sales contract expires and a new "replacement contract" is entered into. Not only was there no record before the Commission which could support the inclusion of this huge non-cost bonus, which differs in both amount and kind from the allowance previously found to be justified by this Court, but the Commission ignored the data in its files indicating that its action would be counterproductive and inhibit rather than encourage additional production efforts for the interstate market.

1. This Court in *Mobil, supra,* has made clear that the Commission is not limited to cost based rates, and, as a matter of rate design, can place some of the burden of the costs for expanding future production upon flowing gas rates and current users thereof rather than imposing the entire burden on the future consumers of newly developed gas. See 417 U.S. at 320. But the Court's approval of contingent escalations of flowing gas rates and refund work-off provisions in the Commission orders in *Mobil* was in context of a Commission decision which (1) had before it for consideration both the old and new gas rates being established for the area involved, (2) involved non-cost supplements which were constructed to "provide opportunity for increased prices that would help in generating capital funds and in meeting rising costs, while assuring that such increases would not be levied upon consumers unless accompanied by increased

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Docket No. RM75-14, the Commission's Bureau of Natural Gas has recommended new gas rates for the 1975-1976 biennial ranging between 85.32 and 169.99 cents per mcf.

supplies of gas" (*id.* at 318), and (3) resulted from the Commission's evaluation of "massive evidence" as to the probable effect of the two proposals and a genuine effort to "seek answers" to the questions posed by the parties questioning the utility of the specific non-cost allowances (*ibid*). None of these factors are present here.

There was no Commission effort in this case to determine the effect of classifying flowing gas sold under "replacement contracts" as new gas. The Commission's several notices in the present rule-making proceeding were expressly limited to the establishment of costs for new gas from "wells commenced after January 1, 1973" (J.A. I, p. 1) with consideration of the appropriate rates for flowing gas from wells commenced *prior* to January 1, 1973 set aside for consideration in a separate rule making proceeding in Docket R-478 initialed on May 23, 1973, shortly after the start of the instant proceeding. And while the Commission directed a number of specific inquiries to the parties (J.A. I, pp. 130-132), none of them related to "replacement" contracts or in any way suggested that the new gas proceeding would be expanded to cover such flowing gas sales. The result is that while some of the producer comments suggested in general terms that old gas sold under "replacement contract" should be afforded the new gas rate, and New York filed brief comments in response (J.A. I, pp. 644-645), there was no record upon which the Commission could determine whether the total revenues available to the producers were inadequate to fund an optimum gas search effort, or the relative percentage of total revenues which should be borne by the rates fixed for flowing gas sales.

Moreover, the Commission refused to evaluate available data useful in determining the efficiency of automatically authorizing flowing gas sold under replacement contracts to secure the much higher new gas rate. New York, among others, had asserted in its comments and petition for rehearing (J.A. IV, p. 729) that permitting producers to secure new gas rates for their flowing gas without any requirement that they devote at least a substantial portion of the increased revenues towards additional production efforts for the interstate market would inhibit actions which the producers might otherwise be induced to take in response to a higher rate for their flowing gas. Under existing gas supply exigencies, we contended, the pipelines would not be in a position to require the producer to agree to expend substantial additional sums for further developmental work for the benefit of the pipeline as a condition for entering into a new contract.[7] And if the producers were entitled to secure the higher new gas rate whenever a replacement contract is entered into, regardless of its terms, the efficiency of existing Commission policies and rules offering producers the prospect of higher rates where they were prepared to make additional expenditures to

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[7] In the absence of a new contract the producer is required to continue service unless and until abandonment is authorized by the Commission. *Sun Oil Company v. FPC*, 364 U.S. 170. And while the producer at the end of the contract period is free of contractual limitations on filing for increased rates (*United Gas Pipeline Co. v. Mobile Gas Service Corp.*, 350 U.S. 332), such filings are subject to Commission moritoria and to the procedures of Sections 4 and 5 of the Natural Gas Act which lead to their denial where the increase has not been shown to be justified.

increase the available gas supply,[8] would be seriously impaired.

We did not ask the Commission to accept our argument solely on the basis of its logic. Instead, we pointed out that the Commission had had experience with a similar if more limited experiment pursuant to its 1972 Opinion No. 639[9] and asserted that an examination of the contracts filed in connection with that

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[8]New York pointed out that the Commission had established the procedures referred to in the statement *supra* at p. 7 to encourage producers to seek rates in excess of the established flowing gas ceilings when they could show that continued or increased production was uneconomic at these norms.

[9]In its brief below the Commission asserted that it was not able to evaluate the effect of the Opinion No. 639 program since that action had not been finally approved by the Court of Appeals until April 15, 1974, when it denied petitions for rehearing of its decision in *Shell Oil Co. v. FPC,* 491 F.2d 82 (5th Cir., 1974). However, as of that date Opinion No. 639 had been in effect for over two years, and as of March, 1974, eight months *before* the Commission issued Opinion No. 699-H, there had been over 210 filings of "replacement contracts" by producers seeking to take advantage of the Commission's interpretation of its rate orders in Opinion No. 639.

It should further be noted that the Circuit Court, in affirming the Commission's experimental program involved the *Shell* case, as a permissible interpretation of previous orders, recognized that New York's "pessimistic prediction of producer behaviour" may "in time prove justified." (491 F.2d at 89), and specifically warned that it would expect similar Commission actions in future rate orders to "be supported by substantial evidence" (*id* at 89-90). See also *Public Service Commission of the State of New York v. FPC,* 467 F.2d 361, 371 (D.C. Cir., 1972) where the court in approving another experimental non-cost increase in producer revenues, since abandoned by the Commission as

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program would demonstrate that of cases no significant new producer efforts were promised in return for the contract permitting them to increase their rates. (J.A. IV, pp. 735-736). The Commission not only made no such inquiry, but totally ignored New York's contentions in Opinion Nos. 699 and 699-H. Nor did it make any effort to consider other means of providing any additional revenues to the producers which would not have the defects of its "replacement contract" plan.[10]

2. The court below recognized that under the standards laid down in *Permian* and *Mobil, supra* it has the "responsibility . . . to make sure that the Commission has exercised its discretion after considering all pertinent options" (Pet. App. A-29). However, it did not, and could not find that the Commission had considered the consumer arguments as to the disutility

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non-productive, stated:

> "Fundamental to the concept of any experiment is the assumption that the data developed from the experience thereunder will be subjected to meaningful review, analysis and evaluation before the experimental practice is allowed to continue or to become institutionalized as a more permanent procedure."

[10]If any non-cost allowance not tied to actual expenditures could be justified, it could be accomplished with greater equity among producers and without depriving producers of an incentive to engage in additional production to secure higher rates for their flowing gas, by an across-the-board allowance of several cents per mcf in flowing gas rates such as the Commission had previously authorized in its second *Permian Basin Area Rate Proceeding*, 50 F.P.C. 933 (1973). Such a proposal also would have had the advantage of making the additional revenues available at once rather than building up over a period of time as old sales contracts expire.

of affording the much higher new gas rate to replacement contracts without any requirement for a production *quid pro quo* either in the light of its experience with its earlier experiment or in context of the relative bargaining power of the producers and pipelines. All it can point to is the Commission's unsupported hope that the pipelines "might be able" to negotiate for additional efforts on the part of the producers (Pet. App. A-29).

Similarily, while the court found that the multibillion non-cost bonus was "supported", though not "compelled", by the "evidence of a [gas] shortage and the need for a massive infusion of funds" (Pet. App. A-30), it perforce did not suggest there was any record basis for concluding that the industry revenues which would be derived at the much higher new gas rate being adopted and from the nationwide flowing rate still to be fixed in Docket R-478, would be inadequate for this task. Nor could it find that there was any record basis for the Commission's suggestion that a large share of the revenues for producer reinvestment had to be internally generated.[11]

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[11]There is no record basis for the Commission's assumption that, because a major share of producer investment funds for gas exploration had traditionally come from internally generated revenues, new funds for an increased gas supply effort could only come from this source, regardless of the price it set for new gas. As the Court of Appeals for the District of Columbia Circuit stated in *Public Service Commission of the State of New York v. FPC*, 487 F.2d 1043, 1073 (1973), remanded *sub nom.* 417 U.S. 964 (1974):

> "It is elementary in the petroleum industry that capital is provided for exploration in an area long before there are

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The Circuit Court apparently felt that the deficiencies in the Commission's findings in justification of its replacement contract caper and in the record support therefore, could be excused because the "experimental" nature of national rate making permitted a "standard of review requiring heightened deference to the Commission's expertise" (Pet. App. A-17), and because it believed the Commission had indicated it would review the program in the biennial review proceeding in Docket No. RM75-14 it had initiated. But there can be no justification for holding the Commission to a lesser standard in its approval of a multibillion dollar bonus to which no obligation for new gas production or even additional production efforts is attached, than was applied by this Court in its evaluation of the contingent escalations of flowing gas rates and the refund work off provisions of the order approved in *Mobil,* where the additional payments were tied to additional gas sales (See 417 U.S. at 318). This is particularly true where, as here, the Commission refused to consider available data with respect to a similar "experimental" program it had initiated almost three years earlier.

Nor can any analysis of whether the Commission's

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any funds flowing from that area – demonstrated, e.g. by the funds invested in Alaska, and in purchase of Gulf Coast off-shore leases offered by the Interior Department. It is obvious that future expenditures in any particular producer area depend on evaluations of future profits, not past or recent receipts from activities begun in the past, at least where, as here, the future operations will be governed by price conditions far more liberal than prevailed at the time current operations were planned and developed."

(*Permian Basin Area Rate Cases, supra,* 390 U.S. at 797.)

On December 12, 1972, however, the Commission suddenly took a different tack. In Opinion 639, the Commission rejected a proposed higher new gas rate for the Appalachian Basin production area (supported by New York) in favor of individual producer utilization of the newly adopted "optional procedure" (See *supra,* p. 6), again stressing that this procedure would permit higher prices for new gas sales where they were instituted without increasing the rates for flowing gas. *Area Rates for the Appalachian and Illinois Basis Areas,* 48 F.P.C. 1299, 1307. However by way of dictum the Commission stated that in view of its objections to "vintaging by contract date" it considered "vintaging to be an anachronism which we should now work to eliminate" (48 F.P.C. at 1309).[3] Accordingly it indicated that it would henceforth adopt a literal interpretation of its various area rate orders under

[3] The Commission attempted to bulwark its statement of policy by suggesting that the Commission had originally contemplated gradual elimination of the two price system, citing for this proposition the Commission's 1960 statement, prior to the initiation of any area rate proceedings, that it expected that the differentials between its "guideline" prices for initial certification of new gas sales and for accepting increased rate filings without suspension would disappear over a period of time. See Statement of General Policy No. 61-1, 24 F.P.C. 818 (1960). In fact, the difference between the initial and increased rate guidelines in most but not all production areas, adopted on an *ex parte* basis by the Commission, were unrelated to the date of original production or contractual commitment to the interstate market, or to the subsequent development of and rationale for the two-price area rate policy.

which sales of flowing gas would be eligible for the higher new gas rates where initial sales contracts had expired and the parties entered into new sales contracts.

The lawfulness *vel non* of this policy was subsequently affirmed in *Shell Oil Company v. F.P.C.* 491 F.2d 82 (5th Cir., 1974), as a permissible exercise of its discretion to interpret its own orders.[4] the Court recognized the potential validity of the claims by New York and others that the gas supply objectives underlying the Commission's policy might be impaired rather than aided and made clear that its action was not to be taken as a blanket approval of all future actions by the Commission to eliminate vintaging; "in each future rate order the Commission must continue to produce substantial evidence to support each essential element of the proposed rate structure" (491 F.2d at 89-90).

B. The Instant Proceeding

The present case was initiated by a notice of proposed rule-making in Docket No. R-389-B issued by the Commission on April 11, 1973 (J.A. I, 1). The proceeding was entitled, "Just and Reasonable National Rates for Future Sales of Natural Gas from Certain

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[4]Challenges to specific implementations of this policy statement were recently rejected by a 2-1 vote of the court in *Public Service Commission of the State of New York, et al. v. F.P.C.*, ____ F.2d ____ (Case Nos. 73-1647 *et al.*, D.C. Cir., issued January 27, 1976). It is contemplated that petitions for certiorari from this opinion will be filed.

Wells," and the notice indicated that "the single uniform just and reasonable rate to be determined by final order herein shall apply to all jurisdictional sales of natural gas produced *from wells commenced on or after January 1, 1973*, except sales certificated under Order No. 431 [short-term sales], or Order No. 455 [the optional procedure]" (J.A. I, 1, emphasis added). The Commission made clear in the notice that it intended to institute a separate rulemaking proceeding "for the establishment of a single national just and reasonable rate for gas sold in interstate commerce from wells commenced prior to January 1, 1973" (J.A. I, 6-7). Such a proceeding was, in fact, initiated on May 23, 1973 by Notice of Proposed Rulemaking in Docket No. R-478, *Nationwide Rulemaking to Establish Just and Reasonable Rates for Natural Gas Produced from Wells Commenced Before January 1, 1973*, 38 F. R. 14295.

Comments and reply comments were filed by numerous parties, including New York on May 16, 1973 and June 1, 1973 respectively (See J.A. III, 218, 220, 288, 289). On March 21, 1974, the Commission issued a supplemental notice calling the attention of the parties to a revised staff nationwide new gas cost study and a staff study of certain AGA data. The parties were invited to file new comments on those studies, as well as on five discrete questions propounded by the Commission (J.A. I, 130-132). Again, nothing in the notice suggested the Commission contemplated expanding the proceeding to encompass any flowing gas. New comments in response to the Commission's supplemental notice were then filed by a number of parties. In the supplementary comments filed by a group of the

major producers (J.A. III, p. 310), it was suggested that the Commission, consistent with Opinion 639, should make its nationwide new gas rate applicable to flowing gas sales when the initial sales contract expires and a new one is entered into. This suggestion was opposed by New York in its supplementary reply comments filed on May 29, 1974 (J.A. IV, pp. 644-648).

On June 21, 1971, the Commission issued its Opinion 699 in this proceeding (Pet. App. C). For purposes of this petition it is sufficient to note that Opinion 699 established a nationwide base rate for new gas of 42 cents per mcf, as of January 1, 1973, with one cent escalations annually. This rate was made applicable to interstate sales undertaken:

(1) from wells commenced on or after January 1, 1973:

(2) pursuant to contracts on or after January 1, 1973, for the sale of gas not previously sold in interstate commerce except on a short term basis under certain Commission regulations; and

(3) "pursuant to contracts executed on or after January 1, 1973 where the sales were formerly made pursuant to permanent certificates of unlimited duration under contracts which expire by their own terms on or after January 1, 1973" (Pet. App. C-2 to C-3).

The Commission gave as its reason for changing its proposal to include flowing gas sales that its action was "consistent" with that taken in Opinion 639, would make additional revenues "available" to producers for expanded exploration and development efforts, and would "offset the claimed attrition in rate of return in various discounted cash flow studies presented by

producer respondents" (Pet. App. C-107 to C-108). No mention was made of the pending proceeding in Docket R-478, and nothing was stated in response to New York's contrary arguments. Commissioner Smith dissented from this aspect of the Commission's action, finding it to be unsupported by the likelihood of benefit to gas consumers. (Pet. App. C-230 to C-232).

Numerous petitions for rehearing of Opinion No. 699 were filed. New York's petition (J.A. IV, 729) among others, expressly challenged the Commission's action in making the new rate applicable to flowing gas sales. At the oral argument held on August 22 and 23, 1974, counsel for New York again set forth the reasons why New York believed the new rate should not apply to flowing gas (See J.A. III, p. 55-56), as did counsel for the Associated Gas Distributors (AGD) (See J.A. III, 38-43).

On December 4, 1974, the Commission issued its Opinion No. 699-H (Pet. App. D). In this opinion, the Commission increased the nationwide base rate to 50 cents per mcf. Opinion 699-H totally ignores the arguments made in the petitions for rehearing and on oral argument by New York and other parties opposing the automatic applicability of the new gas rate to flowing gas sold under replacement contracts. It does discuss, however, a number of requests by the *producers* to enlarge the coverage of its order to include even greater amounts of flowing gas within the new gas umbrella (Pet. App. D-43-D-47). While it rejected a request to make the new gas rate available to flowing gas whenever the initial sales contract expires in situations where the producer and pipeline had failed to enter into a new contract (Pet. App. D-45-D-46), it

modified the availability clause to include flowing gas sales where the term of the initial sales contract expired after January 1, 1973, but the replacement contract had been entered into *prior* thereto (Pet. App. D-44).[5]

Commissioner Smith again dissented from the Commission's action making the new gas rate available to flowing gas (Pet. App. D-112 to D-116). He calculated that the cost to consumers could reach as high as $2.6 billion through 1981, without considering any increases in the new gas rate which might stem from the biennial review provided for in Opinion No. 699-H (*id. at* D-114.) He concluded that the Commission's action was inconsistent with its notices in the proceeding, and that even assuming there were a need to provide additional internal financing for producers, making the new rate available to such flowing gas as would become eligible under the Commission's order was a discriminatory and ineffective method of achieving this objective (*ibid*).

On appeal the Court of Appeals for the Fifth Circuit affirmed the Commission in all respects (Pet. App. A). The court agreed that there was much to be said for the arguments of New York, AGD and the American Public Gas Association that automatically giving the new gas rate to flowing gas sold under replacement contracts would inhibit rather than encourage future development. It concluded, however, that the Commission's determination was lawful since it rested on substantial evidence as to the existence of a gas supply

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[5] The final form of the provision for making the nationwide new gas rate applicable to flowing gas sales is set out as Section 2.56(a)(3)(iii) of the Commission's Statements of General Policy and Interpretations, 18 C.F.R. 2.56(a)(3)(iii) (Pet. App. D).

deficiency and the need of producers for a "massive infusion of funds" to conduct an optimum gas search effort, and since a review of the efficacy of the particular non-cost bonus adopted by the Commission would be undertaken in the biennial review proceeding the Commission had initiated. (Pet. App. C-112 to C-114).

REASONS FOR GRANTING THE WRIT

The Commission in this case adopted a 50 cent nationwide base rate for new gas, approximately double the previous rate ceilings for such gas. New York does not challenge this determination which we believe was within the Commission's discretion as elucidated by this Court in the *Permian Basin Area Rate Cases,* 390 U.S. 747 (1965) and *Mobil Oil Corporation v. FPC,* 417 U.S. 283 (1974). We do challenge the lawfulness, however, of a multibillion dollar[6] non-cost supplement to this

[6] The exact cost of the allowance depends on several variables not presently known. Commissioner Smith in his dissent estimated the cost through 1981 at 2.6 billion dollars, based upon then current flowing gas rates and assuming no increase in the nationwide new gas rate during this period. If one uses the 24.5 cent flowing gas rate, subsequently fixed in Docket R-478 by the Commission's order of December 31, 1975, (and assumes that the 6 cent increase in this rate as of July 1, 1976 for increased federal income taxes will also be applied to the new gas rates), the cost through 1981 would be in excess of 1.8 billion dollars. And if the replacement contracts continue to secure the new gas rate as it is increased in the biennial review proceedings contemplated by the Commission the cost will be greatly in excess of this figure; thus in the first of these proceedings in

(continued)

rate which resulted from the Commission's decision to classify as "new gas" the oldest and least costly flowing gas whenever the initial sales contract expires and a new "replacement contract" is entered into. Not only was there no record before the Commission which could support the inclusion of this huge non-cost bonus, which differs in both amount and kind from the allowance previously found to be justified by this Court, but the Commission ignored the data in its files indicating that its action would be counterproductive and inhibit rather than encourage additional production efforts for the interstate market.

1. This Court in *Mobil, supra*, has made clear that the Commission is not limited to cost based rates, and, as a matter of rate design, can place some of the burden of the costs for expanding future production upon flowing gas rates and current users thereof rather than imposing the entire burden on the future consumers of newly developed gas. See 417 U.S. at 320. But the Court's approval of contingent escalations of flowing gas rates and refund work-off provisions in the Commission orders in *Mobil* was in context of a Commission decision which (1) had before it for consideration both the old and new gas rates being established for the area involved, (2) involved non-cost supplements which were constructed to "provide opportunity for increased prices that would help in generating capital funds and in meeting rising costs, while assuring that such increases would not be levied upon consumers unless accompanied by increased

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Docket No. RM75-14, the Commission's Bureau of Natural Gas has recommended new gas rates for the 1975-1976 biennial ranging between 85.32 and 169.99 cents per mcf.

supplies of gas" (*id.* at 318), and (3) resulted from the Commission's evaluation of "massive evidence" as to the probable effect of the two proposals and a genuine effort to "seek answers" to the questions posed by the parties questioning the utility of the specific non-cost allowances (*ibid*). None of these factors are present here.

There was no Commission effort in this case to determine the effect of classifying flowing gas sold under "replacement contracts" as new gas. The Commission's several notices in the present rule-making proceeding were expressly limited to the establishment of costs for new gas from "wells commenced after January 1, 1973" (J.A. I, p. 1) with consideration of the appropriate rates for flowing gas from wells commenced *prior* to January 1, 1973 set aside for consideration in a separate rule making proceeding in Docket R-478 initialed on May 23, 1973, shortly after the start of the instant proceeding. And while the Commission directed a number of specific inquiries to the parties (J.A. I, pp. 130-132), none of them related to "replacement" contracts or in any way suggested that the new gas proceeding would be expanded to cover such flowing gas sales. The result is that while some of the producer comments suggested in general terms that old gas sold under "replacement contract" should be afforded the new gas rate, and New York filed brief comments in response (J.A. I, pp. 644-645), there was no record upon which the Commission could determine whether the total revenues available to the producers were inadequate to fund an optimum gas search effort, or the relative percentage of total revenues which should be borne by the rates fixed for flowing gas sales.

Moreover, the Commission refused to evaluate available data useful in determining the efficiency of automatically authorizing flowing gas sold under replacement contracts to secure the much higher new gas rate. New York, among others, had asserted in its comments and petition for rehearing (J.A. IV, p. 729) that permitting producers to secure new gas rates for their flowing gas without any requirement that they devote at least a substantial portion of the increased revenues towards additional production efforts for the interstate market would inhibit actions which the producers might otherwise be induced to take in response to a higher rate for their flowing gas. Under existing gas supply exigencies, we contended, the pipelines would not be in a position to require the producer to agree to expend substantial additional sums for further developmental work for the benefit of the pipeline as a condition for entering into a new contract.[7] And if the producers were entitled to secure the higher new gas rate whenever a replacement contract is entered into, regardless of its terms, the efficiency of existing Commission policies and rules offering producers the prospect of higher rates where they were prepared to make additional expenditures to

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[7] In the absence of a new contract the producer is required to continue service unless and until abandonment is authorized by the Commission. *Sun Oil Company v. FPC*, 364 U.S. 170. And while the producer at the end of the contract period is free of contractual limitations on filing for increased rates (*United Gas Pipeline Co. v. Mobile Gas Service Corp.*, 350 U.S. 332), such filings are subject to Commission moritoria and to the procedures of Sections 4 and 5 of the Natural Gas Act which lead to their denial where the increase has not been shown to be justified.

increase the available gas supply,[8] would be seriously impaired.

We did not ask the Commission to accept our argument solely on the basis of its logic. Instead, we pointed out that the Commission had had experience with a similar if more limited experiment pursuant to its 1972 Opinion No. 639[9] and asserted that an examination of the contracts filed in connection with that

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[8]New York pointed out that the Commission had established the procedures referred to in the statement *supra* at p. 7 to encourage producers to seek rates in excess of the established flowing gas ceilings when they could show that continued or increased production was uneconomic at these norms.

[9]In its brief below the Commission asserted that it was not able to evaluate the effect of the Opinion No. 639 program since that action had not been finally approved by the Court of Appeals until April 15, 1974, when it denied petitions for rehearing of its decision in *Shell Oil Co. v. FPC*, 491 F.2d 82 (5th Cir., 1974). However, as of that date Opinion No. 639 had been in effect for over two years, and as of March, 1974, eight months *before* the Commission issued Opinion No. 699-H, there had been over 210 filings of "replacement contracts" by producers seeking to take advantage of the Commission's interpretation of its rate orders in Opinion No. 639.

It should further be noted that the Circuit Court, in affirming the Commission's experimental program involved the *Shell* case, as a permissible interpretation of previous orders, recognized that New York's "pessimistic prediction of producer behaviour" may "in time prove justified." (491 F.2d at 89), and specifically warned that it would expect similar Commission actions in future rate orders to "be supported by substantial evidence" (*id* at 89-90). See also *Public Service Commission of the State of New York v. FPC*, 467 F.2d 361, 371 (D.C. Cir., 1972) where the court in approving another experimental non-cost increase in producer revenues, since abandoned by the Commission as

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program would demonstrate that of cases no significant new producer efforts were promised in return for the contract permitting them to increase their rates. (J.A. IV, pp. 735-736). The Commission not only made no such inquiry, but totally ignored New York's contentions in Opinion Nos. 699 and 699-H. Nor did it make any effort to consider other means of providing any additional revenues to the producers which would not have the defects of its "replacement contract" plan.[10]

2. The court below recognized that under the standards laid down in *Permian* and *Mobil, supra* it has the "responsibility . . . to make sure that the Commission has exercised its discretion after considering all pertinent options" (Pet. App. A-29). However, it did not, and could not find that the Commission had considered the consumer arguments as to the disutility

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non-productive, stated:

> "Fundamental to the concept of any experiment is the assumption that the data developed from the experience thereunder will be subjected to meaningful review, analysis and evaluation before the experimental practice is allowed to continue or to become institutionalized as a more permanent procedure."

[10]If any non-cost allowance not tied to actual expenditures could be justified, it could be accomplished with greater equity among producers and without depriving producers of an incentive to engage in additional production to secure higher rates for their flowing gas, by an across-the-board allowance of several cents per mcf in flowing gas rates such as the Commission had previously authorized in its second *Permian Basin Area Rate Proceeding*, 50 F.P.C. 933 (1973). Such a proposal also would have had the advantage of making the additional revenues available at once rather than building up over a period of time as old sales contracts expire.

of affording the much higher new gas rate to replacement contracts without any requirement for a production *quid pro quo* either in the light of its experience with its earlier experiment or in context of the relative bargaining power of the producers and pipelines. All it can point to is the Commission's unsupported hope that the pipelines "might be able" to negotiate for additional efforts on the part of the producers (Pet. App. A-29).

Similarily, while the court found that the multibillion non-cost bonus was "supported", though not "compelled", by the "evidence of a [gas] shortage and the need for a massive infusion of funds" (Pet. App. A-30), it perforce did not suggest there was any record basis for concluding that the industry revenues which would be derived at the much higher new gas rate being adopted and from the nationwide flowing rate still to be fixed in Docket R-478, would be inadequate for this task. Nor could it find that there was any record basis for the Commission's suggestion that a large share of the revenues for producer reinvestment had to be internally generated.[11]

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[11]There is no record basis for the Commission's assumption that, because a major share of producer investment funds for gas exploration had traditionally come from internally generated revenues, new funds for an increased gas supply effort could only come from this source, regardless of the price it set for new gas. As the Court of Appeals for the District of Columbia Circuit stated in *Public Service Commission of the State of New York v. FPC*, 487 F.2d 1043, 1073 (1973), remanded *sub nom.* 417 U.S. 964 (1974):

> "It is elementary in the petroleum industry that capital is provided for exploration in an area long before there are

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The Circuit Court apparently felt that the deficiencies in the Commission's findings in justification of its replacement contract caper and in the record support therefore, could be excused because the "experimental" nature of national rate making permitted a "standard of review requiring heightened deference to the Commission's expertise" (Pet. App. A-17), and because it believed the Commission had indicated it would review the program in the biennial review proceeding in Docket No. RM75-14 it had initiated. But there can be no justification for holding the Commission to a lesser standard in its approval of a multibillion dollar bonus to which no obligation for new gas production or even additional production efforts is attached, than was applied by this Court in its evaluation of the contingent escalations of flowing gas rates and the refund work off provisions of the order approved in *Mobil,* where the additional payments were tied to additional gas sales (See 417 U.S. at 318). This is particularly true where, as here, the Commission refused to consider available data with respect to a similar "experimental" program it had initiated almost three years earlier.

Nor can any analysis of whether the Commission's

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any funds flowing from that area – demonstrated, e.g. by the funds invested in Alaska, and in purchase of Gulf Coast off-shore leases offered by the Interior Department. It is obvious that future expenditures in any particular producer area depend on evaluations of future profits, not past or recent receipts from activities begun in the past, at least where, as here, the future operations will be governed by price conditions far more liberal than prevailed at the time current operations were planned and developed."

program is likely to be worth its great cost be put over to subsequent biennial review proceedings. The portion of the Commission's Opinion No. 699-H cited by the Court (Pet. App. A-30) does not relate to the issue of whether replacement contracts should secure the new gas rate, but rather to its determination to permit the new gas rates to escalate as it fixes ever higher rates in its biennial proceedings (Pet. App. D-52-D-56). Even in this context there is no suggestion that any price roll back would be ordered but only that some additional escalations of the rates for new gas might be deferred if at some unspecified future date the program proves to be unsuccessful in inducing new development. We would certainly hope and expect that the Commission will not permit the rates for old flowing gas sold under replacement contracts to increase should the Commission adopt new gas rates in the on-going biennial proceeding at the levels recommended by its staff (See n. 6, *supra*). But surely a multibillion dollar non-cost bonus of the type involved here cannot be justified because the Commission might reject substantial increases therein when it finally agrees it has proven to be ineffective.

This Court made clear in *Mobil, supra* that it is the circuit courts which have the primary responsibility for determining whether each major facet of the Commission's decision in an area or nationwide rate case rests on a reasoned analysis of the issues based upon substantial record evidence. The court below, however, was only able to find that there was substantial evidence of the existence of a problem and did not and could not have concluded that the Commission's response thereto of granting new gas rates to the oldest

portions of the flowing gas supply rested on any factual predicate indicating that any additional gas production which might result therefrom would justify the huge additional cost burden imposed on gas consumers. This failure was, in turn, in large part attributable to the Commission's failure to solicit information as to the utility of the allowance or to avail itself of the data in its files which would have permitted a more meaningful analysis. Under these circumstances, we submit, plenary review by this Court is both appropriate and required to prevent a massive diversion of funds for which little or no public benefit has been shown to be forthcoming.

CONCLUSION

For the reasons set forth above the Court should grant the petition for a writ of certiorari to review that portion of the decision below which upheld the Commission's action in authorizing flowing gas sold under replacement contracts to secure the higher new gas rates.

Respectfully submitted,

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1975

No. 75-1305

PUBLIC SERVICE COMMISSION OF THE
STATE OF NEW YORK,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

REPLY OF THE PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK TO BRIEF IN OPPOSITION OF THE FEDERAL POWER COMMISSION

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REPLY OF THE PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK TO BRIEF IN OPPOSITION OF THE FEDERAL POWER COMMISSION

The petition for a writ of certiorari filed in this case by the Public Service Commission of the State of New York ("New York"), like the petition filed in Case No. 75-1308 by The Associated Gas Distributors ("AGD"), is limited to one important and novel feature of the Federal Power Commission's opinion establishing a nationwide rate for new gas production.[1] This is the Commission's automatic application of the higher rate it established for new gas to the oldest and cheapest vintages of flowing gas, at a multibillion dollar cost to gas consum-

[1] The issue has also been raised in the petition filed by the American Public Gas Association (APGA) in Case No. 75-1304.

ers, whenever the producer and pipeline enter into a new sales contract at the expiration of the initial contract.

The Commission's Brief in Opposition [2] does not purport to deny the great and continuing significance of the issue. Moreover, since the Commission's action of which we complain constitutes a marked departure from its actions in the previous area rate proceedings considered by this Court, the Commission cannot and does not suggest that the questions raised by New York and AGD are disposed of by the Court's decision in the *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), or *Mobil Oil Corporation* v. *Federal Power Commission*, 417 U.S. 283 (1974). Instead, without any serious effort to discuss the specific contentions made by New York as to the deficiencies in the Commission's and Court of Appeals' justifications for this multibillion dollar non-cost increase in the rates producers can charge for flowing gas without assurances that any portion of this huge fund would be devoted to further efforts for the interstate gas market, the Commission confines itself to citing the court's recital of its own inadequate findings and conclusions.

The Court below believed that in view of the still "experimental" nature of producer pricing, a "kid glove treatment" of otherwise inadequate Commission findings was required (Pet. App. A-19). Under this standard of review it believed that the huge non-cost allowance could be justified in view of the Commission's general finding that an adequate gas supply effort would require a "massive commitment of new funds" and the court's erroneous reading of the Commission opinions as find-

[2] Pursuant to leave granted by this Court, the Commission's opposition to New York's petition, and five others seeking review of the same Court of Appeals opinion, was filed on May 27, 1976 under the style of "The California Company, et al. v. Federal Power Commission".

ing that "internally generated funds are a *necessary* source of such funds" (Pet. App. A-29, emphasis added),[3] coupled with the Commission's expressed hope "that by requiring an old contract to be renegotiated before the new rate is recoverable, the pipeline *might* be able to negotiate for additional acreage dedication to interstate commerce, or exploration and development activity on previously dedicated acreage, or other concessions for the price increase" (*ibid.*). The court of appeals also apparently believed that the Commission's action in authorizing the multibillion dollar allowance was excusable since it was "tentative" and subject to reconsideration in the biennial review proceeding the Commission had initiated in the light of its evaluation therein of whether the additional revenues generated had in fact led to greater gas search efforts. (Pet. App. A-30). The Commission Brief in Opposition significantly does not rely on this part of the opinion below. This is because, as New York stated in its petition, the only reconsideration of this matter the Commission apparently intends to entertain in the biennial review proceeding is as to whether the still higher new gas rate established therein should be made available to the oldest and cheapest vintages of flowing gas.

If this were a situation such as that presented in the *Mobil* case *supra*, where potentially large non-cost increases in flowing gas revenues were authorized only to

[3] While the Commission found that much of the capital for producer production efforts had typically come from gas production revenues (Pet. App. D-16, D-55-56), it did *not* find that internally generated gas revenues were the "necessary" source of funds for an optimum gas search effort. It could not do so in view of record data as to the availability of other funds if the opportunity price is right (see, *e.g.*, Pet. App. C-267-270) and industry experience in virgin areas such as the North Slope of Alaska and the North Sea. See *Public Service Commission of the State of New York* v. *Federal Power Commission*, 487 F.2d 1043, 1073 (D.C. Cir., 1973), remanded *sub nom.*, 417 U.S. 964 (1974).

the extent that additional gas was in fact dedicated to the interstate market, it might be less important for the Commission to have some factual basis for believing that at least a substantial portion of its largesse would be devoted to additional efforts to secure gas for the interstate market.[4] But even in such circumstances and even if the Commission's determination was in fact a tentative one subject to prospective recission in the biennial review proceeding, it would not have justified the Commission's complete refusal to address itself in any of its opinions to the arguments against its proposal made by New York, AGD, and the American Public Gas Association, or to make any effort to evaluate the results of a similar, if more limited, experimental program it had initiated two years earlier. The court below recognized its responsibility was to ensure that the "Commission has exercised its discretion after considering all pertinent options" (Pet. App. A-29). The simple fact is that the Commission made no effort to do so before granting the producers a multibillion non-cost allowance for which no *quid pro quo* was required.

Even if it is assumed that the establishment of an appropriate new gas price approximately double that previously in existence would be inadequate to induce the necessary additional effort by the producers in the absence of an increased cash flow from existing gas sales, (but see n.3, *supra*), the method chosen by the Commission for achieving this objective was unsupportable. The Commission itself recognized that it "cannot set a price for new gas without also considering the cash flow consequences of its pricing policies for old gas" (Pet. App.

[4] Thus the contingent escalations of flowing gas rates approved by this Court in the *Mobil* case *supra*, never became effective since the producers did *not* dedicate the requisite additional volumes of gas to the interstate market. This is also true with respect to the contingent escalation provisions included in several other Commission area rate orders.

C-97). However, it made no effort to consider whether any conceivable inadequacy of the cash flow available under the flowing gas rates of its pre-existing area rate orders would be eliminated by higher national rates for flowing gas to be established in the separate proceeding it had established for that purpose in Docket No. 478.[5] Equally important, the Commission completely ignored the arguments of New York and AGD that automatically granting producers the new gas price when they are able to persuade the pipeline to enter into a new contract not only would not lead to substantial new investment on behalf of the interstate market but would be likely to detract from the efficacy of the Commission's existing programs to use price as a regulatory tool to induce new efforts in behalf of the interstate market.

If, contrary to New York's view, it could be demonstrated that an optimum increase in production efforts on behalf of the interstate market required a discrete increase in gas revenues over the ensuing six years of the magnitude indicated by the Commission's action in permitting producers to charge the new gas rate for their oldest and cheapest gas, (and this revenue increase would not in any event result from the increased rates to be authorized for flowing gas), the first questions one would expect the Commission to consider were why such increases should be assigned to the oldest and most rapidly depleting vintages of flowing gas rather than as a

[5] In Opinion No. 749 in Docket No. 478, issued on December 31, 1975, the Commission fixed the nationwide rate for old gas at a level of 23.5 cents per Mcf, escalating to 29.5 cents per Mcf as of July 1, 1976. The great bulk of rates for gas classifiable as old gas was sold under rates established by the pre-existing area rate orders at levels considerably below either figure, ranging down to 12.5 cents for gas produced in the Panhandle and Hugoton fields in Kansas. (In those few cases where the old gas area price was above the nationwide level fixed by the Commission, the higher area rate prevails.) On February 27 1976 the Commission granted rehearing of Opinion No. 749 for the purpose of further consideration of a number of petitions for rehearing.

per Mcf allowance for all old gas,[6] and why such allowance, regardless of the vintage of flowing gas to which it is applied, should not, as a minimum, be tied to a pledge by the recipient producer to expend the amount received in additional gas supply efforts for the interstate market. No such consideration appears to have been given by the Commission prior to adoption of its program here. It simply is not good enough for the Commission to suggest that its insistence that the new gas price will be available only when producer and pipeline enter into a replacement contract, *might* give some of the pipelines sufficient leverage to require some *quid pro quo* for the increased revenues. In a period of acute gas shortage the far more likely possibility is that if the pipelines with expiring sales contracts wish to secure any of the offshore gas the producers might then or in the future have for sale (and are in any event obligated to sell to the interstate market) they will have to agree to sign new contracts which would authorize the producer to secure the new gas levels for their flowing gas.

[6] Thus the Commission noted (Pet. App. C-96, n. 118) that in some area rate orders it had provided an additional non-cost allowance of several cents per Mcf to provide what it believed was an adequate cash flow for future reinvestment. A two cent per Mcf surcharge on the approximately 22.5 Tcf of flowing gas produced as of the end of 1972 (Pet. App. C-126), assuming depletion at a level of 10% per year, would produce additional revenues of about $2,075,964,000 over the same 8 year period Commissioner Smith utilized in estimating the cost of the Commission's allowance in issue here. But unlike the Commission's plan, which would start out in 1974 with a yield of about $127.2 million and build up to an annual amount of $560.7 million in 1981, an across the board surcharge would produce the largest sum at the beginning of the eight year period when it assertedly is most needed. Equally important, any across the board surcharge, even if it was tied to producer reinvestment of the additional revenues in gas production efforts on behalf of the interstate market, would retain a substantial differential between new and old gas rates, and thus continue to provide an incentive for producers to upgrade production on their existing wells in return for further price concessions.

The Commission appears to suggest at page 15 of its Opposition that in view of the gas supply shortage it can, in effect, establish whatever higher producer rates it believes appropriate and gas consumers then have the burden of demonstrating that its conclusion is utterly devoid of rational content. Recognizing that a reviewing court cannot substitute its or our judgment for that of the Commission where it fixes upon a course of conduct after considering all available evidence and the arguments pro and con, nothing this court has previously stated can be interpreted as providing the Commission with the blank check which it seeks here.

The Commission neither proposed to make its national new gas rate applicable to flowing gas sold under renewable contracts in its various notices in the rulemaking proceeding or sought to secure a record on this question (though it requested comments on many other facets of the new gas rate.). It has ignored all arguments against its action. It has refused to examine the available record of its earlier similar experiment to test the validity of our claims that the expanded program, far from producing any substantial increase in interstate gas supply to match its huge cost, would be likely to lessen the existing incentive of producers to up-grade their flowing gas operations through well reconditioning or other undertakings in return for a rate increase. And it gave no apparent consideration to possible alternatives which would be less costly or more effective. Under these circumstances it is imperative that this Court grant the petitions for certiorari which seek to review the Commission's action which permits producers to collect billions of additional dollars in revenues, unrelated to their costs, but does not require them to devote any portion thereof to efforts to increase the gas supply for the consumers required to pay the tab.

CONCLUSION

For the reasons set forth herein and in the initial petition filed by New York, the question of the validity of the Commission's action authorizing the nationwide new gas to be automatically available to old low cost gas sold under replacement contracts is both novel and of great importance to the proper exercise of the Commission's responsibilities under the Natural Gas Act. Certiorari accordingly should be granted to review this facet of the court of appeals opinion below.

Respectfully submitted,

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